TUESLEY • HALL • KONOPA, LLP
attorneys

Succession Planning 101: If You Plan to Succeed, You Need a Succession Plan

So you've survived the hard part. You've gotten your business off the ground and past the start-up stage, and you have an established, successful business. Or you have completed your purchase of an established, successful business and are past the initial transition from the previous owner. You've realized your dream of owning your own business. It's all smooth sailing from here, right? Wrong.

If you've gotten this far, most likely you had a plan for your business, and you have been executing that plan. As the saying goes, "if you fail to plan, you are planning to fail." But typical business planning focused on growing revenue, controlling expenses, or marketing your products or services is only part of planning for long-term success. Just as important, but often neglected (or overlooked entirely) by business owners, is business succession planning (also sometimes called exit planning).

For many businesses, and especially for businesses that are owned and operated by the founder or founders of the business, much of the success of the business is directly attributable to the business owner. It may be your entrepreneurial spirit, or the force of your personality, or your technical expertise, or some combination of all of those. But like it or not you aren't going to be around forever. And even if you could figure out a way to achieve immortality, presumably you would like to be able to exit the business at some point and more fully enjoy the fruits of your labor. And for many business owners, their business has been a labor of love, and they want their business (like their children) to be successful long after they are gone.

Developing, and then implementing, a good succession plan is an answer to the question of how you can maintain and realize the value of your business, ensure its long-term success, and exit the business on your terms and on your timeline.

How do you develop and implement a good succession plan? Here are ten steps that provide an overview of the process:

(1) Assemble Your Professional Team (Financial Planning, Tax, Legal, and Insurance)
(2) Define Your Desired Personal Financial Objectives and Exit Timeline
(3) Determine the Value of Your Business
(4) Identify Your Desired Successor (Family, Key Employee, Third Party)
(5) Assess Possible Succession Plan Structures Based on 2 through 4
(6) Evaluate the Financial Fit of the Possible Structures With Your Desired Personal Financial Objectives and Exit Timeline
(7) Evaluate the Interpersonal and Psychological Fit of the Desired Successor With You and the Business
(8) If You Have a Good Fit, Further Develop the Plan, Including the Timeline and Methods for Building and Protecting the Value of the Business and for Transferring the Business to the Successor
(9) If You Do Not Have a Good Fit, Go Back to Step 2 (or Step 4) and Start Over
(10) Once Your Plan is Developed, Implement It (But Be Prepared to Be Flexible and to Revisit the Plan Over Time As Necessary)

Below we will cover these ten steps in greater detail.

Steps 1 through 3 – Start with the Basics

Step 1: Assemble Your Professional Team (Financial Planning, Tax, Legal, and Insurance)

Developing and implementing a good succession plan is an interdisciplinary effort. You should involve a professional team that includes you and your financial planner, accountant, business attorney, estate planning attorney, and insurance agent. If you already have these relationships in place, you should meet with your team to discuss your desire to develop and implement a succession plan. If you do not have any of these relationships in place, now is the time to establish them. Relationship referrals tend to be the best way to make these connections, so a good approach is to ask the existing team members for referrals to help you fill the missing roles. If you only have one of these relationships in place, start by meeting with that team member and build your team from there. And be sure to have a designated quarterback (whether that is you or one of the other team members). It is important to have one person charged with keeping the process moving forward.

Step 2: Define Your Desired Personal Financial Objectives and Exit Timeline

Before you can develop an effective plan, you need to first define your desired outcomes for the plan. If you don't know where you want to end up, then there is very little chance of you getting there. This means you have to take time to do some soul-searching about your personal objectives, both financial and otherwise. This includes your feelings about when you want to exit your business and what you want to do once you have. And this requires that you give some serious thought to what your financial needs and wants will realistically look like if your other desired outcomes are achieved. For example, if you are a 45-year-old business owner, and you want to retire when you are 65 and play golf at your local course once a week, achieving those objectives is likely going to be much easier than if you want to retire at 50 and travel the world playing every Jack Nicklaus designed golf course. Your identification of your desired outcomes for the plan, therefore, needs to include a reasonable level of needs and wants financial analysis and projections based on your income generating assets (including, of course, your business).

Step 3: Determine the Value of Your Business

Once you have your professional team in place and have defined your desired outcomes for your succession plan, the next step is for you to determine at least the approximate value of your business. This may mean an informal valuation discussion with your accountant and financial planner, or this may mean a formal business valuation by a Certified Valuation Analyst or similarly accredited professional. And it is possible you may start with an informal valuation and then later in the planning process have a formal valuation prepared when the time is right. Either way, this step is critical, as it allows you early on in the process to see whether your desired financial outcomes appear likely to match up with your financial reality. This, in turn, helps you avoid incurring unnecessary expense and frustration heading down a succession planning path that is not realistic based on your financial needs or wants and on the estimated value of your business and the income-generating value of your other assets.

After completing steps one through three, you will have assembled your professional team, defined your personal financial objectives and timeline, and determined at least an approximate value for your business. Now, it is time to turn your attention to developing and evaluating possible succession plan structures.

Steps 4 through 7 - Develop the Structure

Step 4: Identify Your Desired Successor (Family, Key Employee, Third Party)

To have a succession plan, you need a successor. Typical potential successors would be one or more family members, one or more key employees, or an unrelated third party. Which of these is right for you depends on your circumstances. Do you have family members active in the business? Do you believe those family members have “what it takes” to run the business? Do you have key employees you believe have “what it takes” to run the business? Would your business be appealing to a third party purchaser?

What priority do you place on the legacy of your business and whether it continues to be run after you are gone by people who you feel are of like mind to you? You should give these questions serious thought and determine who your desired successors would be in your perfect world.

Step 5: Assess Possible Succession Plan Structures Based on 2 through 4

With steps one through four completed, you should work with your team of advisors to develop and evaluate possible plan structures that might fit with the value of the business and your desired successors. These will include transaction type (transfer of business assets or business stock), purchase price (how determined and whether at a discount or a premium), payment terms (cash at closing or down payment with installment note - and if an installment note, over what term and at what interest rate), handling of management transition from you to successors, and handling of any business real estate (included in business succession transaction or excluded and retained by you).

Step 6: Evaluate the Financial Fit of the Possible Structures With Your Desired Personal Financial Objectives and Exit Timeline

Once you and your team have developed and evaluated possible structures that may work for the value of the business and for your desired successors, you need to evaluate the financial fit of those plan structures with your desired personal financial objectives and exit timeline. If your preference is to sell your business to your children, or perhaps key employee(s), will your children or key employee(s) be able or willing to pay you a sufficient amount at closing or within a sufficiently short period of time after closing to meet your financial objectives and exit timeline? If you would prefer to sell to a third party, will current market conditions support a third party valuation of your business that matches up with your financial objectives?

Step 7: Evaluate the Interpersonal and Psychological Fit of the Desired Successor With You and the Business

Finally, you need to evaluate the interpersonal and psychological fit of the desired successor with you and your business. This can be a difficult task and more art than science. While the financial fit relies heavily on mathematical calculations and forecasts, this fit is more subjective and difficult to assess. But, it is critically important to a successful plan and as the owner, you must be honest with yourself, perhaps even brutally so, in completing this step. If you don’t honestly believe that your son, or daughter, or key employee, or third-party purchaser is up to the task of owning and successfully running and growing your business, and if their failure to do so would undermine the financial viability of your succession plan, then that may not be the right plan for you. Or, if you believe the successor can succeed but is likely to turn the business into something you will not feel good about for your legacy, then that may not be the right plan for you.

After completing steps one through seven, you will have assembled your professional team, defined your personal financial objectives and timeline, determined at least an approximate value for your business, identified your desired successor, and developed and evaluated possible succession plan structures.

After all that, it is finally time for you to begin to implement your succession plan.

Steps 8 through 10 - Implement But Be Flexible

Step 8: If You Have a Good Fit, Further Develop the Plan, Including the Timeline and Methods for Building and Protecting the Value of the Business and for Transferring the Business to the Successor

If your personal financial objectives and desired exit timeline, approximate value of your business, and your desired successor all match up well, then it is time for you to further develop your plan. This should include a targeted timeline for beginning to implement your plan and for completion of your plan. It should also include the development of methods for building and protecting the value of your business and for transferring the business to a successor.

Examples of further plan development here might include:
(1) determining whether/when to begin to transfer minority ownership interests to designated family member successors or key employee successors;
(2) ensuring that critical business functions can be handled by one or more key employees and that the business' success and survival are not overly dependent on your involvement;
(3) protecting the value of the business through confidentiality, non-competition, or stay bonus agreements with key employees; or
(4) developing a timeline for a sale to an outside third party and possibly identifying a business broker or investment banking firm to engage for assistance with marketing the business for sale.

Step 9: If You Do Not Have a Good Fit, Go Back to Step 2 (or Step 4) and Start Over

Sometimes one or more of your personal financial objectives, desired timeline, approximate value of your business, and desired successor do not match up well.

Maybe your plan has always been to have one or more of your kids take over the business, but after going through Steps 1 through 7, you now realize that none of your kids really want to take over the family business. Or maybe they do want to, but you now realize they don't really have what it takes to manage the business successfully.

Or perhaps you were hoping to sell the business to a third party for $5 million, but your professional valuation report is telling you the business is only worth $2.5 million, and that amount will not meet your personal financial objectives.

Whatever the reason, if the path you thought you were headed down is clearly not going to work, it is important that you not waste valuable time pursuing that path any further. Instead, it is time to go back to Step 2 (or Step 4) and start over because you will need to change one or more aspects of your plan.

You may need to do one or more of the following: adjust your personal financial objectives; adjust your timeline; change your desired successor; or find a way to increase the value of your business.

Step 10: Once Your Plan is Developed, Implement It (But Be Prepared to Be Flexible and to Revisit the Plan Over Time As Necessary)

Life and business often do not go according to plan. It may be a downturn in the economy, or a change in your industry, or a health issue for you or your successor, but the odds are good that your succession plan will encounter unexpected obstacles.

So, as your plan unfolds you must continue to review and revisit the plan to be sure it continues to meet your objectives, and you must be prepared to be flexible and adapt the plan to changing circumstances.

Author: Eric W. Seigel is a business lawyer and partner at Tuesley Hall Konopa, LLP. He helps his business clients with day-to-day business law needs, contract review and negotiation, business acquisitions and sales, and exit and succession planning. He is licensed to practice in Indiana and Michigan.

You can contact Eric by calling 574.232.3538 or by email at eseigel@thklaw.com.